United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

orig.

74-2614
74-2657
75-7010

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P/S

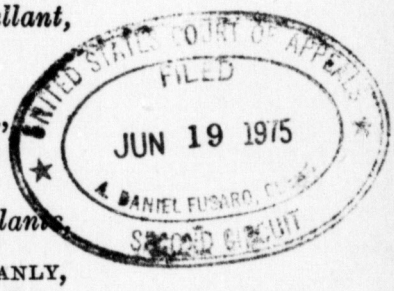
United States Court of Appeals
FOR THE SECOND CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellant,

—against—

GEON INDUSTRIES, INC., et al.,
GEON INDUSTRIES, INC. and
GEORGE O. NEUWIRTH
Defendants-Appellants,

FRANK BLOOM and EDWARDS & HANLY,
Defendants-Appellees.



On Appeal from the United States District Court for the Southern District of New York

REPLY BRIEF OF DEFENDANTS—APPELLANTS GEON INDUSTRIES, INC. AND GEORGE O. NEUWIRTH

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ARGUMENT

POINT I

The District Court's Determination that Neuwirth Communicated Non-Public Information to Rauch Should be Reversed.

In Neuwirth's principal brief on this appeal, it was pointed out that while the District Court held that he had communicated material non-public information to Rauch, (a) there was no finding of what Neuwirth is supposed to have said to Rauch, and (b) there is no evidence in the

record of any communication of material non-public information concerning Geon by Neuwirth to Rauch. While the SEC was challenged to point to any such evidence, it has failed to do so in the less than one page of its brief devoted to this issue. The SEC concludes its discussion of this point by saying:

> "[A]ccordingly, there is ample basis for the district court's finding 'that Rauch . . . had numerous opportunities for acquiring inside information' from Mr. Neuwirth (I. 67a)." (SEC Answering Brief, p. 17)

There is no support for the novel proposition that a person can be held liable for a violation of the securities laws if only a mere opportunity existed for acquiring inside information. Accordingly, since there was no evidence of a *communication* of material non-public information from Neuwirth to Rauch, the determination that Neuwirth violated Rule 10b-5 by providing material non-public information to Rauch must be reversed.

POINT II

The District Court's Determination that Geon is Liable Under Rule 10b-5 Should be Reversed.

A. If this Court reverses the District Court's determination that Neuwirth provided material non-public information to Rauch, it must reverse the determination that Geon is liable under Rule 10b-5.

If this Court reverses the District Court's determination that Neuwirth provided material non-public information concerning Geon to Rauch, it must reverse the determination that Geon is liable under Rule 10b-5, irrespective of whether it reverses the District Court's determination that Neuwirth provided material non-public information to Alpert.

As stated in Geon's principal brief, a corporation may be held liable for an employee's violations of Rule 10b-5 either as a "controlling person" under Section 20(a) of

the Securities Exchange Act of 1934 or by virtue of the concept that a corporation is liable for the acts of an employee acting within the scope of his authority. *Securities and Exchange Commission* v. *Management Dynamics, Inc., et al.,* CCH Fed. Sec. L. Rep. ¶ 95,017 (2d Cir. March 18, 1975); *Gordon* v. *Burr,* 506 F.2d 1080 (2d Cir. 1974); *Lanza* v. *Drexel & Co.,* 479 F.2d 1277 (2d Cir. 1973).

"Controlling persons" liability attaches only if the corporation had knowledge of the fraudulent representations or culpably participated in them in a meaningful sense. *Gordon* v. *Burr, supra; Lanza* v. *Drexel, supra.* Here, there is no evidence of any such knowledge or participation, the District Court made no finding thereof, and the SEC does not urge Section 20(a) of the Securities Exchange Act of 1934 as a basis for holding Geon liable.

The SEC does urge, however, that Geon be held liable because Neuwirth was then chief executive officer of Geon. The SEC asserts that further analysis is not required once Neuwirth's place in the Geon corporate structure is identified. However, in *SEC* v. *Management Dynamics, Inc., et al.,* CCH Fed. Sec. L. Rep. ¶ 95,017 (2d Cir. March 18, 1975), this Court did not hold that a corporation is liable for any act of an employee. In that case, the SEC argued and the Court held that a corporation is liable for the acts of an employee "acting within the scope of his authority."

In talking to Alpert in October, 1973, December, 1973 and February, 1974, Neuwirth was not acting in his capacity as an officer or representative of Geon. The conversations were social, not business. The October, 1973 conversation took place at the bar of Neuwirth's club (II 215). The February, 1974 conversation took place at a restaurant while Neuwirth, Alpert and their wives had dinner (III 281-2), and the December, 1973 conversation was a telephone conversation concerning Neuwirth's availability for a birthday party (III 263-4). Clearly, on none of these occasions was Neuwirth acting within the scope of his authority as the chief executive officer of Geon. Consequently, Geon cannot be held liable by virtue of the conversations between Neuwirth and Alpert.

B. Geon should not be held liable by virtue of McMahon's violations.

The SEC urges that Geon be held liable for the violations of Rule 10b-5 committed by defendant James McMahon.

McMahon consented to the entry of a permanent injunction. The District Court did not hold Geon liable by virtue of his violations.

While McMahon is no longer connected with Geon, at the time relevant to the issues herein, he was controller of Geon Intercontinental Corp., a wholly-owned subsidiary of defendant Geon (II 81). He was not an officer of either corporation.

In each of the three cases cited at page 21 of the SEC's answering brief, a corporation or partnership was held liable for the acts of an employee acting within the scope of his employment. Here, in calling his broker some time after midnight to sell his stock and that of his father-in-law (I 57a), McMahon was not acting within the scope of his employment.

Nor is there any basis for holding Geon liable under Section 20(a) of the Securities Exchange Act of 1934. Geon had no knowledge of that phone call, nor did it participate in any way in McMahon's activities. Quite to the contrary, immediately upon learning of the facts concerning McMahon's conversation with and sale of stock through Rauch, Geon, through its counsel, immediately notified the American Stock Exchange. When Rauch was faced with the necessity of testifying before the American Stock Exchange, he urged McMahon to go along with his proposal to tell a false story. McMahon refused and voluntarily told Geon and Geon's counsel of his calls to Rauch in the early morning of February 22, 1974 and of his sales of Geon stock (IV 560-62). Geon's counsel immediately telephoned the American Stock Exchange and told them of McMahon's confession and Rauch's attempt to have him go along with a fabricated story (V 862).

While the SEC suggests that Geon should have devised procedures to prevent McMahon from violating the law, no suggestion is made as to what procedures possibly could have been utilized to prevent McMahon from making the telephone call from his home at one o'clock in the morning. The short answer is that there is no conceivable procedure that could have prevented it.

POINT III

The District Court Erred in Finding that Neuwirth Provided Material Non-Public Information to Alpert.

A. The October Purchase

As demonstrated in Neuwirth's principal brief, the statements that he made to Alpert in October, 1973 (the content of which is not in dispute) could not have constituted a communication of material non-public information concerning Geon because no material facts concerning a possible Geon-Burmah transaction were then in existence. The SEC has responded by taking liberties with the record in an attempt to create materiality where there is none. Several examples will illustrate this.

At pages 3 and 4 of its Answering Brief, the SEC asserts:

> "In the summer of 1973, Geon Industries, Inc. commenced preliminary discussions with Burmah Oil Co., Ltd., *concerning a possible merger* between the two companies (SEC Brief 9)." (emphasis supplied)

However, neither the portions of the record to which citation is made at page 9 of the SEC's initial brief, nor any other evidence in the record supports the contention that the discussions held in the summer of 1973 "concerned a possible merger" of Geon and Burmah.

Footnote 2 appearing at page 4 of the SEC's Answering Brief recites:

> "Geon had been interested in locating another company with which it could merge for some time and in

> July 1973 had retained Drexel-Burnham & Co., a registered broker-dealer, to arrange for discussions concerning a possible merger with Burmah (II. 177-182; SEC Exhibit 11)."

Apparently the SEC would have this Court believe that Geon was then avidly pursuing a merger. Again, there is nothing at the cited portions of the record, or any other part of the record, to support the proposition that Geon had evinced any interest whatsoever in locating another company with which it could merge. Nor is there anything in the record to support the proposition that Geon retained Drexel, Burnham to arrange for discussions with Burmah. The fact is that Drexel, Burnham approached Geon in the first instance to inquire whether there was any interest in meeting representatives of another company (II 20-1, 177-8). Exhibit 11 to which the SEC refers (not reproduced in the Appendix) is a letter prepared by Drexel, Burnham and submitted to Geon for its signature, to provide for a fee if Drexel, Burnham's introduction ever led to a transaction between Geon and Burmah.

At page 4 of the SEC's answering brief, the following assertion appears:

> "[I]n October 1973 Burmah 'said that they were interested in really taking a look at Geon' (II. 34) and wanted to find out 'if the company [Geon] was interested in them [Burmah]' (II. 34-35)."

The actual testimony of Bloom, appearing at these pages, is as follows:

> "[A]nd then we were at this point in October where they said that they were interested in really taking a look at Geon, at that point in time and finding out if the company interested them."

Thus, the true thrust of the testimony was that Burmah wanted to look at Geon to see if Geon was *of interest* to Burmah, not whether Geon was interested in Burmah. The

testimony thus depicts a more tentative and preliminary state of facts than the SEC's mischaracterization would lead one to believe.

Also at page 4 of its brief, the SEC states that Neuwirth, his son and Frank Bloom visited Burmah at its Swindon headquarters "apparently in response to Burmah's overture." Neither the cited page nor any other portion of the record supports the proposition that the visit to Swindon was in response to any overture by Burmah. On the contrary, Neuwirth, who was going to England for the Earl's Court Auto Show in any event, decided he would take that opportunity to meet the people at Burmah (II 35, 209-10).

At page 5 of the SEC's brief, it is asserted:

> "While at Burmah's headquarters in Swindon, Geon's officers had a two and one-half hour meeting with Burmah's 'chief financial man' (II. 37) and subsequently met with Peter Simonis, 'a top executive of Burmah' (II. 38-40; III. 222)."

The above-quoted passage constitutes the grossest kind of distortion. The SEC's assertion evokes the image of Geon people closeted with Burmah's chief financial man alone for the lengthy period of 2½ hours. The actual testimony of Bloom and Neuwirth is entirely different. They testified that the entire time spent at Burmah's headquarters, including lunch, was 2½ hours, that the only time they met with Burmah's chief financial man was within a group at lunch at which no business was discussed, and that following lunch they met briefly with Simonis (II 37-8, III 224-5, 227-30). There is just no testimony that the Geon people met alone with Burmah's chief financial man for any time, let alone two and a half hours.

The SEC's legal argument with regard to Alpert's October purchase consists of setting up a straw man and knocking him down. The SEC attributes arguments to Neuwirth that he never made and ignores the arguments that he did make. At page 12 of its brief, the SEC charac-

terizes Neuwirth's argument as asserting that his statements to Alpert did not constitute "material" information ". . . because Geon and Burmah had not *completed* their merger negotiations . . .". In fact, Neuwirth maintains that, at the time of his conversation with Alpert, merger negotiations had not even *started.* (See pages 33 through 38 of Neuwirth's principal brief).

Also at page 12 of its brief, the SEC says "[B]ut there is no requirement under the authorities noted above, that the merger must have been an absolute certainty or even highly probable" as if Neuwirth had argued that there was such a requirement. As pointed out at page 39 of Neuwirth's principal brief, at the time of his October, 1973 conversation with Alpert, there was neither a reasonable likelihood nor a likelihood of any measurable probability that a transaction between Geon and Burmah would take place.

The SEC's bald assertion at page 13 of its brief—"In any event, the likelihood of a merger between Geon and Burmah had plainly passed beyond the stage of a mere possibility"—is "supported" only by a citation to pages 3 and 4 of the very same brief which, as noted above, contains assertions wholly unsupported by the record.

The SEC places substantial reliance on the case of *SEC* v. *Shapiro,* 494 F.2d 1301 (2d Cir. 1974). However, it is clear that the *Shapiro* case is substantially dissimiliar to the instant one. In *Shapiro,* the defendant, at the time he purchased the Harvey shares, knew that a director of Harvey's had stated that he looked favorably upon the proposed merger between Harvey's and Ridge Manor, and the defendant also knew that it had been projected that if Ridge Manor were to merge with Harvey's, that would result in a 600 percent increase in Harvey's earnings per share.

The Court in *Shapiro* distinguished *List* v. *Fashion Park,* 340 F.2d 457 (2d Cir. 1965), *cert. denied,* 382 U.S. 811 (1965) in the following terms:

> "In *List* the defendant, who was a director of Fashion Park, purchased stock in the company from plaintiff. Two days prior to the sale Fashion Park commenced negotiations which ultimately led to a merger. However, defendant was unaware of these negotiations at the time of the purchase. He knew only that Fashion Park's board had resolved to seek a merger or sale and that there might be an unidentified purchaser on the horizon. We affirmed the decision of the district court that this information was not material." 393 F.2d at 1306.

As appears at pages 39-40 of Neuwirth's principal brief, at the time of Alpert's October, 1973 purchase he knew less than defendant Lerner knew in the *List* case. Like Lerner, Alpert did not know the identity of any prospective purchaser, and he did not know the terms of any proposed purchase because there were none. Unlike Lerner, Alpert did not know nor could he know that either Geon or Burmah had proposed to go forward with a transaction because neither had so resolved. If Mr. Lerner was not in possession of material facts, it follows *a fortiori* that when Alpert purchased Geon stock in October, 1973, he did not have material facts.

At page 12 of its brief, the SEC asserts:

> "Moreover, similar to the situation found by this Court in *Shapiro, supra,* 494 F.2d at 1307, one 'need not merely speculate as to how a reasonable investor might have received his information,' *because of the conduct of the recipient who trades directly on inside information* 'demonstrates empirically that the information was material.' " (emphasis supplied)

In interrupting the quotation from the decision in *Shapiro,* the SEC substituted its own words for the following words of the Court:

> "The behavior of appellant, his partner Shapiro, and others who knew of the merger, *all of whom were sophisticated investors* . . . ." 393 F.2d at 1307 (emphasis supplied)

In so doing, the SEC sought to change "sophisticated investor" into "recipient", thereby obscuring the rationale of that decision. There is neither a finding nor evidence to indicate that Mr. Alpert, who is in the real estate and building business (III 318) is a sophisticated investor.

B. The December 19 Purchase.

The discussion appearing at pages 13, 14 and 16 of the SEC's answering brief is virtually a concession that the court erred in finding that Alpert's December 19 purchase was based upon the material non-public information communicated by Neuwirth. The SEC suggests that the material non-public information communicated by Neuwirth to Alpert prior to such transaction was that Neuwirth had told Roy Alpert "that he could not attend his own birthday party, planned for December 17, because he was staying in New York City and was too busy with his business commitments." That statement is simply not material non-public information concerning Geon.

It should be noted that in its recitation of the facts and circumstances attendant upon Alpert's December 19 purchase, the SEC did not see fit to bring to the Court's attention the press release issued by Geon on December 18, 1973, the day before Alpert's purchase in which it is stated that Geon's negotiations with Burmah were continuing and that Geon expected to make further announcement based upon developments in the negotiations by the end of the week (Geon Exhibit D, I 172a). Similarly, the SEC nowhere refers to Alpert's testimony that when he bought Geon stock on December 19 he did *not* know that Neuwirth was talking to Burmah (III 344). It is clear, therefore, that when Alpert purchased Geon stock on December 19, 1974 he had less knowledge than the public at large.

C. Alpert's February Sale.

As Neuwirth has argued, since Alpert's February sale was not based on any adverse information concerning Geon communicated by Neuwirth, Alpert's sale on February 22, 1974 was not effected while he was in possession of any material non-public information concerning Geon conveyed to him by Neuwirth. The SEC's response at page 16 of its brief is:

> "[B]ut in this instance, the lack of an official announcement and of any other communication from Mr. Neuwirth to Mr. Alpert was equivalent to a communication that something unforeseen had occurred—something of such materiality that the proposed merger had not been 'rubber stamped.' "*

The SEC would be correct if Neuwirth had told Alpert to expect an official announcement or that he would call Alpert if the Geon board rubber stamped the contract. Under such circumstances, silence by Neuwirth would have been tantamount to a communication. However, there is no evidence that Neuwirth told Alpert to expect a public announcement, and both Neuwirth and Alpert testified that Neuwirth did not say he would call Alpert nor did Alpert ask him to call in the event that Geon's board approved the contract (III 283, 338-9). There was just no discussion on that subject. Consequently, under the facts as they exist in the instant case, Neuwirth did not communicate anything to Alpert by silence.

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* At page 14 of its brief, the SEC asserts: "Presumably an announcement would issue as soon as the deal was 'rubber stamped' (V. 848-50)." The testimony appearing at the cited pages demonstrates precisely the opposite, *i.e.* it was agreed that no announcement would be made after Geon's board approved the contract, but that a press release would be issued immediately following the execution of the agreement.

CONCLUSION

For all of the reasons stated above, this Court should:

1. Vacate the injunction against Neuwirth, reverse the District Court's determination that he violated Rule 10b-5, and dismiss the complaint as to him;

2. Vacate the injunction against Geon, reverse the District Court's determination that Geon is liable as a violator of 10b-5, and dismiss the complaint as to it.

Respectfully submitted,

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AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

WADE T. DEMPSEY, being duly sworn, deposes and says that he is employed by the law firm of Kaye, Scholer, Fierman, Hays & Handler, is over the age of twenty-one years and not a party to this action.

1. On the 19th day of June, 1975, deponent served 2 true copies of Reply Brief of Defendants-Appellants, annexed hereto, by depositing same, enclosed in a sealed postpaid wrapper in the post office box regularly maintained by the U.S. Postal Service at 425 Park Avenue, New York, New York, addressed to the following attorney:

Van Carter, Esq.
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549.

Wade T. Dempsey
Wade T. Dempsey

Sworn to before me this
19th day of June, 1975

Robert Thatcher
Notary Public

ROBERT THATCHER
Notary Public, State of New York
No. 9310825
Qualified in Kings County
Certificate filed in New York County
Commission Expires March 30, 1976

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DELSON & GORDON
ATTORNEYS FOR